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BEFORE THE
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DISCOVER FINANCIAL SERVICES NSA	MC2015-3
DISCOVER FINANCIAL SERVICES NSA	R2015-2

Preliminary Comments of Discover Financial Services
(November 13, 2014)

Discover Financial Services hereby submits these preliminary Comments for the purpose of clarifying several matters undergirding the NSA brought before the Commission in the instant dockets.

I.

While this NSA encompasses both First Class and Standard mail, Discover *does not* expect its First-Class behavior and volumes to be influenced in any significant way by the Negotiated Service Agreement (NSA), unless there is a change in the way we do business, and we do not foresee such a change. Discover's First-Class volumes have not been growing for the last several years, and for the most part have been slowly and steadily decreasing. This is largely consumer driven, and we expect that trend to continue.

Discover's declining First-Class spend is included in this NSA as part of the business metric by which the size of the Discover rebate will be measured. By doing so, we achieve a very simple value proposition: if Discover does not move marketing dollars from mail to digital, and as a result its *total mail spend* increases by a specified amount in each of the contract years, then a certain percentage of Discover's *total mail spend* will be rebated. If the increase exceeds the specified amounts by a prescribed percentage in a given year, then the rebate will increase by a specified amount.

Each year is measured separately. If Discover does not reach either of the negotiated revenue thresholds or the corresponding volume thresholds in any given year, it pays a penalty. That is a straightforward, uncomplicated value proposition, typical of business deals, and familiar to executives at Discover and business executives generally. In the business thought process at play here, the size of the overall incentive is critical, but the class or number of pieces, incentives per piece, or anything of the like are nothing more than complicating distractions. In contrast, the value proposition in this NSA is anything but complicated: it seeks to ensure, as is perfectly appropriate for an NSA, that tens of millions of Discover marketing dollars remain in the mail and that Discover increases its total postal spend.

Some might try to criticize this NSA for including First Class, suggesting that Discover and the Postal Service should have negotiated this NSA in a different way, e.g., limiting it only to declining block discounts in Standard Mail, and urge the Commission to reject it on such grounds. That criticism really boils down to someone not liking a square peg, and suggesting that the crafters of the peg should have made it a round peg. Discover and the Postal Service negotiated this NSA to meet the needs of *both* Discover and the Postal Service, and not the needs of anyone else and doing so is not only perfectly acceptable under the law, but it also is the point of having an NSA.

It is true that Discover and the Postal Service could have negotiated this NSA differently, while achieving similar financial results. But that is not the contract that the parties chose to negotiate, and that is not the contract that would have met the needs of both parties. Both parties preferred a simpler and more businesslike approach that acknowledges the significant improvement in the effectiveness of Discover's digital marketing channels, and provides Discover with an incentive not to divert marketing dollars from the mail channel to digital channels. Discover is rewarded if it maintains its mail spend with the Postal Service, and improves that spend. The Postal Service is rewarded by *retaining* Discover's marketing dollars and contribution in the face of competition from less expensive and similarly effective digital channels.

II.

Retention is at the heart of this NSA. Retention involves decisions to use or not use a channel, and whether one should change course and move funding from one channel to another. It is a decision-making process that is somewhat different from an allocation of dollars among channels. In this context, it might be helpful to think of mail in this NSA as fighting more *for the market*, rather than *in the market.*

This is why Discover made the unprecedented effort to prepare a Statement from Discover's Chief Marketing Officer, Harit Talwar explaining how Discover markets in order to help the Commission understand the entirety of the context in which this NSA was developed. Key takeaways from that Statement should be an awareness that the Postal Service faces multiple competitors offering multiple digital channels,[1] that these digital channels are now very effective competitors, and that Discover's decision-making

[1] The Talwar Statement overlooked one of the digital channels, the Refer-a-Friend channel (RAF). This channel is an online referral program where current Discover cardmembers can send invitations to their friends, either via email or social post (Facebook, Twitter, LinkedIn). Cardmembers access the RAF tool on the account center or on the Discover mobile application. An invitee can use the link that is shared to them (via the cardmember) and apply for a Discover card. If they are approved, the cardmember who shared and the new account that applied via the shared link each get a $50 Cashback Bonus. Discover mostly market this tool through their own digital assets (AC web targeting, emails, etc.) but also do some paid digital media by targeting known Discover cardmembers on Facebook.

process is an integrated one that makes it difficult if not impossible to honestly isolate the effect of price alone on the decision to use its various marketing channels.

It is also important to realize that the dynamic mail faces in its competition for Discover's mail dollars did not exist 15 years ago, and even five to ten years ago was not as strong as it is today. This is demonstrated by the fact that last year, for the first time, *more than half of Discover's new acquisitions* came in through the digital channels. That is a fundamental change for Discover, and a major milestone in the marketing revolution wrought by digital communications. This is a milestone the Commission and its staff should take note of. Likewise, the Postal Service must pay attention to these developments, and react accordingly, as it is doing in this NSA and as the PAEA intended, or the Postal Service will find itself relegated to anonymity by the market. This NSA seeks to prevent that, at least in Discover's case, just as the paradigm shift begins.

III.

The fact that First Class revenues count towards the thresholds in this NSA is an additional benefit to the Postal Service. This is because having a steadily declining First Class revenue stream included in the NSA's aggregate revenue and volume thresholds means that Discover must compensate for declining First Class revenue by steadily increasing its Standard Mail revenue stream, on a dollar per dollar basis.[2] That is, if Discover wishes to receive a rebate, it first must increase its Standard Mail spend to make up for the loss to the Postal Service of its First Class Mail spend decline, and then

[2]This compensatory mechanism is not the same as that in our previous NSA, which keyed on contribution rather than spend, but it will help compensate the Postal Service for the First-Class revenue that it will be losing from Discover.

increase its spend even further to meet a threshold. That is a major benefit for the Postal Service.

Finally, since the rebate will be based on Discover's total mail spend, that means that there is an incentive in place to increase First Class revenues. While Discover does not anticipate its operations mail (statements, letters, etc.) increasing, there are some very creative marketers at Discover, and this incentive could focus them on developing new, ingenious ways to use First Class for marketing purposes. While we do not anticipate that this will occur, having such incentives in place is another smart outcome negotiated by the Postal Service, and it is an example of the type of incentive usage anticipated by the PAEA. Were Discover to come up with a viable new use for First Class Mail in the marketing area, the Postal Service would stand to profit enormously, not just from Discover and this NSA, but from the entire industry and beyond.

IV.

Discover's previous NSA included all Discover Full Service IMB mail. That was not only the Full Service IMB mail that was paid for through Discover CAPS accounts, but also the Full Service IMB mail that was not paid through a Discover CAPS account, but through a Caps account of one of Discover's vendors. This volume was fairly small since Discover generally insists that vendors use its CAPS accounts rather than their own. Reconciliation of this Discover non-CAPS account mail proved to be a complicated and difficult task. Given the relatively small amounts involved, it was a disproportionately complicated and difficult task, and took a disproportionately long time to accomplish for both the Postal Service and Discover. We have made a change in this area in this NSA, in order to make reconciliation more efficient, and thus this NSA is limited to letter mail entered only through Discover's CAPS accounts.

There is a second unrelated but parallel issue that we have also dealt with in this NSA. Our previous NSA applied only to Discover *Full Service* IMB mail. All of Discover's mail is designed and intended to be Full Service IMB mail, and pieces that fail to qualify for Full Service fail simply because of a mistake. There are some but not very many mistakes. Since all of Discover's mail (excluding mistakes) is Full Service IMB mail, the previous NSA *essentially* applied to all of Discover's bulk First Class and Standard Full Service IMB mail.

Since the previous contract terms limited qualifying mail to *only* Full Service IMB, under the contract the Postal Service and Discover both had to go back and weed out those pieces that ultimately failed to qualify for Full Service. Much like the case with the Discover CAPS pieces described above, reconciliation of this extremely small amount of mail proved to be a complicated and difficult task, and it too took a disproportionately long time to accomplish. Thus, in this NSA, for the sake of simplicity, qualifying mail is *all letter mail* entered through the Discover CAPS account, not just Full Service.

V.

Question 5 of CHIR No. I asks about effective dates and implementation dates. Discover 's understanding is that the effective date generally comes first, followed by the implementation date. Ideally, both would be the same, but there might be times when a mailer has to finish some action (IT adjustments easily come to mind) after the effective date but before the implementation date—i.e., the mailer technologically cannot implement the NSA until a particular IT project is completed.

But that is not the case here. In this case, Discover anticipates that both the effective and implementation date would be the same and we currently are considering implementing the NSA on the effective date, barring some unforeseen complication. While we realize that the contract might not be crystal clear on this point, our interpretation of this contract is that the implementation date could not come before the effective date.

Thank you for considering our views.

Respectfully submitted,

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